MINORITY SHAREHOLDINGS AND MERGER CONTROL IN PORTUGAL

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ABSTRACT: *This paper discusses the competitive effects of minority shareholdings and their role in Merger Control in Portugal. The existence of common shareholders in competing firms is also discussed, as it may imply considering, under certain circumstances, those firms as one economic unit, for the purposes of the application of competition rules. We also present a case of remedy implementation, where minority shareholdings on the merged entity were considered to assess the independent nature of a company which was proposed to manage a power plant.*

SUMMARY: Introduction. Unilateral Effects of Minority Shareholdings. Coordinated effects of Minority Shareholdings. Minority Shareholdings in Portuguese Merger Control. Common Shareholders in Competing Firms. Minority Shareholdings in Remedy Implementation. Conclusion.

INTRODUCTION

Recently, in 2008, the OECD Competition Committee[3] debated the topic of minority shareholdings and interlocking directorates[4], as there may be negative

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2 The author gratefully acknowledges the helpful comments of Ana Sofia Rodrigues, and the help of Paulo Gonçalves in reviewing the paper. The views expressed are those of the author and do not necessarily represent those of the Portuguese Competition Authority.

3 OECD, Policy Roundtables – Minority Shareholdings, 2008, www.oecd.org/dataoecd/40/38/41774055.pdf [date of access: 15.11.2009].

4 Interlocking directorates refer to situations in which one or more companies have one or more members of their respective board in common.

effects on competition both on an unilateral perspective, through the reduction of individual incentives to compete, and on a coordinated perspective, by facilitating collusion.

The relevance of the topic to merger control relates to the possible existence of an enforcement gap. In fact, in most jurisdictions, minority shareholdings are only taken into account in merger control review in so far as these shareholdings allow for some type of control over the undertaking at stake. Although minority shareholdings may have an impact on the structure of competition between the players in the market, these are often not duly considered when analysing the possible negative effects on competition resulting from a merger.

A shareholder has a minority shareholding or partial ownership whenever it holds less than 50% of the voting rights or equity rights of a company, the target company. This minority shareholding may or may not entitle the shareholder to exercise control over the company, i.e., the ability to exercise decisive influence over its strategic decisions.

Hence, minority interests may be active, if they entitle the owner to exercise some sort of control or influence over the target company, or passive, if the shareholder is only entitled to a share in the profits or losses of the target. Competition concerns may, however, arise from both active and passive minority shareholdings[5].

In this paper we will give a short overview on the possible unilateral and coordinated effects of minority shareholdings, and will discuss these issues in the context of Portuguese merger control. Common shareholders in competing firms will also be analysed, as it has been considered in a merger case review by the Portuguese Competition Authority (PCA). Finally, we also present a situation of remedy implementation, where minority shareholdings were relevant, particularly in the assessment of the independent nature of a company which was proposed to manage a power plant, in consequence of a remedy imposed on EDP[6], following a merger review by PCA.

5 Most equity investments are benign and can generate efficiencies, as they can contribute to reduce and diversify risks, to develop, manufacture, and market new products, to gain access to markets, to improve managerial practices, to enhance technological capabilities through research and development (R&D), and so on. However, when these investments involve actual or potential competitors, possible competition concerns might arise, which ought to be balanced with the benefits.

6 EDP accounts for most electricity production capacity in Portugal.

UNILATERAL EFFECTS OF MINORITY SHAREHOLDINGS

Focusing on unilateral effects as a consequence of minority shareholdings, economic theory shows it is possible that, for example, when a firm owns equity in a competitor, the firm will have an incentive to unilaterally reduce output and increase prices. Profit maximization by the firm will take into consideration the profit of the competitor, in which it has a passive shareholding, producing a positive correlation among their profits.

In the context of a modified Cournot Model, with identical firms producing homogeneous products at constant marginal costs, which considers that entry is blockaded or it is a difficult and lengthy process, Reynolds & Snapp (1986) show that, independently of increased opportunities for collusion, there are structural effects of partial equity interests, when the firms involved are actual or potential competitors.

The losses in sales incurred, as a result of unilateral output restrictions by the investing firm, may be partially recovered through the minority share in the participated firm, and firm's incentives to compete are reduced. Market output will be a declining function of the extent to which firms are linked, because these equity investments link the profits of the firms involved, and thus have an effect on their profit maximisation. On the contrary, with ease of entry, new firms would be attracted by the increased profits in the markets, and any rents would be eliminated.

If only a few firms are linked and the links are small, it is expected that output will not be restricted significantly. However, when all the firms in the market are linked, the reduction in output may be significant[7]. Reciprocal links will enhance output restriction in the market. Additionally, the higher the level of the ownership interests, the higher the incentives for output reduction.

The unilateral effects that may arise from minority shareholdings will depend on several factors, starting with the structure of the market. An oligopolistic structure, with few firms, and high barriers to entry, increases the likelihood of unilateral price rises. However, one must also give particular attention to the size of the minority interest, the market share of the target, the degree of substitutability between the investing firm and the participa-

7 Reynolds & Snapp (1986: p. 146) examined the output effects of widespread ownership linkages, using quantitative estimates. As an example, the authors show that "if five Cournot competitors had ten percent equity interests in each other, equilibrium market output would be 10.0 percent less". Moreover, when ownerships interests are at the maximum level, regardless of the number of firms in the market, firms will produce the monopoly output.

ted firm, the diversion ratio between the two firms, and the firm's respective variable costs and margins.

The mere existence of minority shareholdings will not necessarily lead to unilateral effects, given that the likelihood that a price increase will be profitable depends on several factors. When assessing the effects of such structural links between competing firms, competition agencies should take into consideration both the structural and the transaction specific variables which may influence the profit maximisation of firms in the market.

Additional factors to consider may be the inability to capture the benefits associated with the minority stake, potentially conflicting incentives of management (particularly when it is not the firm which directly owns an equity interest in its competitors, but it is an indirect interest by a controlling shareholder), the inability to influence the target's management decisions or incomplete information on the target, which should all be looked at with caution.

In the presence of minority shareholdings linking competitors, the usual Herfindahl-Hirschman concentration index (HHI)[8] will understate the level of concentration in the market. Bresnahan & Salop (1986) have developed a Modified Herfindahl-Hirshman Index[9] (MHHI[10]) to take into account partial equity acquisitions, which can be used to identify possible competition concerns involving minority shareholdings, albeit, just as with the HHI, this index should only be the first indicator and not a sufficient tool to conclude competition concerns will in fact arise.

If we were in the presence of a full merger between two firms in the market, the MHHI delta would be twice the product of the firms' market shares, which would be exactly the same as the HHI delta. In the case of the acquisition by

8 The HHI index corresponds to the sum of the squared market shares of the firms in the market. The difference between the pre and post merger HHI is given by the so-called *delta*. For the use of HHI, see, for example, the 1992 Guidelines of the US FTC and DOJ on Horizontal mergers and the European Commission Guidelines on the Assessment of Horizontal Mergers (OJ C 31, 5.2.2004).

9 The MHHI was developed in the context of horizontal joint ventures, within the standard non-cooperative oligopoly model. The authors looked at different financial interest and control mechanisms which might govern joint venture agreements: silent financial interest (where the parents have no control over the pricing or output decisions of the joint venture); control by one parent with silent financial interest; full ownership by one parent; financial interest plus joint control; and financial interest plus competitor-based escalator clauses. The work of Bresnahan & Salop (1986) was further developed in O'Brian & Salop (2002) and O'Brian & Salop (2001).

10 The European Commission has used the MHHI in its Decision on Case No IV/M.1383 – Exxon/Mobil, §256, 29.9.1999; and on Case COMP/M.2283 – Schneider/Legrand, §18, 30.1.2002. In Portugal, the MHHI has not been used. For an application on the MHHI, see also "A powerful competition policy", Report No. 1/2003 of the Nordic Competition Authorities.

one firm of a pure equity interest, the MHHI delta equals the equity interest times the product of the two firms' market shares. This will be lower than in the case of a full merger, but the acquisition of a non-controlling minority shareholding would not be captured by the HHI delta (which would be zero), where the MHHI would be higher than the HHI.

The MHHI can still be adjusted for control, i.e., taking into account the degree of control that can be exercised by a minority shareholding. One way to adjust the MHHI is to use the Banzhaf power index which is based on the idea that the voting power of a member reflects how often the voting share can be used to swing a losing coalition into a winning one[11]. One may also use the Shapley-Shubik index (also known as Shapley value), a measure of a player's power in any voting game, to take account for control, which measures how often a player contributes to the creation of a winning coalition[12].

COORDINATED EFFECTS OF MINORITY SHAREHOLDINGS

Structural links between competitors, through minority shareholdings, may also cause coordinated effects, as they may facilitate tacit or explicit collusion. Three conditions are necessary for coordination[13]: there must be sufficient market transparency in order to monitor whether or not the firms are adopting the common policy; the retaliation or punishment in case of deviation must be severe and credible; the foreseeable reaction of actual and potential competitors, as well as of consumers, must not jeopardise the common policy.

Passive investments may, in some circumstances, contribute to the conditions for the establishment or the stability of collusion, by increasing transparency or negatively affecting the incentives for competition among firms.

These equity interests may allow the investing firm to access sensitive information on the business strategy of the target, such as prices or investments, increasing transparency and facilitating monitoring of common policy. This can be enhanced if the investing firm is able to appoint board members or senior managers.

The existence of links between the companies may also change their payoffs, which affects their incentives to compete. The investing firm, for example,

11 For an application, see the Report No. 1/2003 of the Nordic Competition Authorities.

12 For an application, see Campos & Vega (2004).

13 These conditions were highlighted by the Court of First Instance in the case Case T-342/99, Airtours plc v Commission of the European Communities, before the Court of First Instance of the European Communities (Fifth Chamber) [2002] ECR II-02585.

may refrain from price-cutting on a collusive price, as it would suffer part of the losses the target firm would incur. Coordinated effects may be particularly relevant when a maverick firm invests on a competitor, as it signals to the companies in the market its intention of not competing vigorously. The industry maverick, which could be making collusion unstable before the equity investment, would be signalling its commitment not to price-cut.

MINORITY SHAREHOLDINGS IN PORTUGUESE MERGER CONTROL

Merger Control in Portugal follows closely the European Union regime[14], based on the notion of "concentration", which occurs when there is a lasting change in control over the target business. According to article 8 (3) of the Portuguese Competition Law[15], control results from the ability to exercise a decisive influence over the activity of a company, and can be a *sole* or a *joint control*, exercised on a *de jure* or a *de facto* basis.

In the case of acquisitions of joint control, the PCA has in the past blocked mergers[16], as a dominant position would be created or reinforced, resulting in significant impediment to competition in the relevant markets.

Through the acquisition of a minority shareholding, the acquiring firm may be able to exercise control over the target company. These acquisitions of control, as long as notification threshold are met, are under Portuguese merger control jurisdiction, as there can be joint control[17] over the company, or even sole control[18].

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14 See Council Regulation (EC) No. 139/2004 of 20 January 2004 on the control of concentrations between undertakings; Official Journal L 24, 29.01.2004.

15 Law No. 18/2003, of 11 of June.

16 See Case Ccent. 37/2004 – Barraqueiro / Arriva, 25.11.2005; and Case Ccent. 22/2005 – Brisa / AEA / AEO, 07.04.2006.

17 The Portuguese Competition Authority has analysed several acquisitions of joint control, involving the acquisition of minority shareholdings, under 50% of the voting rights or equity rights of a company; see, for example, cases Ccent. 20/2003 – KONONKLIJKE PHILIPS ELECT, NV / ACCTON CORP – APWN, 03.07.2003; Ccent. 53/2003 – CTT / MAILTEC HOLDING, 26.02.2004; Ccent. 36/2004 – PETROCER / PARPÚBLICA, 23.12.2004; Ccent. 2/2004 – CGD * BES / LOCARENT, 04.03.2004; Ccent. 41/2004 – ES Viagens / Sonae Turismo / Ibéria / Mundo VIP, 01.02.2005; Ccent. 48/2004 – EMBRAER / EADS / EMPORDEF (OGMA), 17.02.2005; Ccent. 50/2005 – NATUREZA / JULIAN MARTIN / CAJA DUERO, 29.09.2005; Ccent. 58/2005 – IBERSUIZAS e OUTROS / SELENIS, 09.11.2005; Ccent. 45/2006 – Inter-Risco / Serlima Gest / Serlima Services, 23.11.2006; Ccent. 80/2005 – Farmindústria / JMP II / Alliance Santé / Alliance Unichem, 31.01.2007; Ccent. 1/2007 – SAG GEST – Nuno Lobo / AUTOLOMBOS, 23.02.2007; Ccent. 57/2008 – Change / Mundo VIP, 24.10.2008; Ccent. 29/2008 – MOTA ENGIL / ES CONCESSÕES / ASCENDI, 19.06.2008; Ccent. 22/2009 – ES TECH Ventures * Caixa Web * Portugal Telecom / PT Prime Tradecom, 23.07.2009.

18 See Case Ccent. 39/2009 – Unicer / NewCoffee II, 30.10.2009, where the acquisition by Unicer of a shareholding of [30-40]% was considered to constitute the acquisition of negative sole control over NewCoffee II.

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However, the acquisition of passive minority shareholdings, i.e., non-controlling minority shareholdings, do not constitute a concentration, according to Article 8 of the Portuguese Competition Law, and, as such, the PCA has no jurisdiction over those transactions in what concerns *ex-ante* scrutiny.

When a transaction constitutes a concentration, passive minority shareholdings are not taken into account for the purpose of calculating the turnover of the undertakings concerned[19], and thus are not considered when verifying whether the turnover threshold is met. These passive shareholdings are also not considered for the purposes of market share threshold verification.

One should note, however, that the Portuguese notification form[20], in its section 3.3., requires information from the notifying parties concerning situations in which the notifying parties have one or more members of their respective board in common with companies which operate in the same relevant markets, and requires them to list the companies in which they hold a minority shareholding, which operate in the same relevant markets. In some cases, the same information may be required concerning companies active in related markets.

This means that the PCA, whenever a concentration meets the notification thresholds, and is subject to review, may take into account the holding of minority shares by the notifying parties, as part of its assessment of the case. This can be the case of an acquisition of control over a company, even when there is no vertical or horizontal overlap with the activities of the acquirer, when the acquirer already owns minority shareholdings in the same relevant markets or in related markets.

The Portuguese Competition Law establishes a dominance test for merger review. As such, in the presence of minority shareholdings, it is important to verify if those shareholdings may contribute to the creation or strengthening of a dominant position, unilateral or collective, which results in significant impediment to effective competition. Notwithstanding, up to present the PCA has not contested a merger on the basis of existing minority shareholdings in competing firms.

If the role of minority shareholdings in Portuguese merger control is similar to the European regime, other jurisdictions allow for a more relevant role. This is the case of the United States, Germany, Austria, United Kingdom or Norway.

19 See Article 10 of the Portuguese Competition Law (Law No. 18/2003, of 11 of June).

20 Regulamento No. 120/2009, of 17.03.2009, available at www.concorrencia.pt [date of access: 15.11.2009].

In the United States, according to Section 7 of the Clayton Antitrust Act, which governs mergers and acquisitions, antitrust authorities are granted jurisdiction over partial acquisitions of horizontal competitors, even if the acquisition does not allow for control over the target company, and independently of the size of the shareholding acquired ("the whole or any part of the stock or other share capital"), as the effect of such acquisition may be substantially to lessen competition[21]. As stated in Section 7, "[t]his section shall not apply to corporations purchasing such stock solely for investment and not using the same by voting or otherwise to bring about, or in attempting to bring about, the substantial lessening of competition". Even though it is not necessary that an acquisition of control occurs, for the application of Section 7, it is required a certain degree of influence over the actions of the target firm, such as the ability to appoint a member of the target's board, or access, by the acquirer, to sensitive information regarding the activities of the target company.

Merger provisions in Germany and Austria also apply to passive minority shareholding acquisitions, given that all acquisitions of at least 25% shareholding in a company are under the jurisdiction of the Bundeskartellamt[22] and the Austrian Federal Competition Authority.

The United Kingdom has a voluntary notification regime, which allows for vigilance on minority shareholdings acquisitions without increasing the burden on companies. A mere passive investment by non-competing firms will generally not be notified or lead to an *ex-officio* intervention by the OFT. However, non-controlling minority stakes may be subject to scrutiny[23] as there can be a material influence of the target company which may raise substantive issues.

21 Issues relating to interlocking directorships are covered by Section 8 of the Clayton Act.

22 See, for example, Decision of the Bundeskartellamt of 27.02.2007, B5-27742 Fa 198/07, A-Tec/Norddeutsche Affinerie, where the acquisition of a 13.75% shareholding of Norddeutsche Affinerie by the Austrian copper manufacturer and rival A-Tec, including the right to appoint three members of the supervisory board, was prohibited on the basis that it would have created a dominant position on the EEA market for oxygen-free copper billets.

23 See, for example, Case BSkyB/ITV, where the acquisition of a 17.9% shareholding in ITV by Sky was ultimately blocked by the Competition Comission ("CC"), as the CC concluded that BSkyB would have the ability materially to influence the policy on ITV and would exercise its ability so as substantially to lessen competition in the market for all-television services (Acquisition by British Sky Broadcasting Group Plc of 17.9 percent of the shares in ITV Plc Report sent to Secretary of State (BERR) 14 December 2007). For an analysis on this case and on the ruling of the Competition Appeal Tribunal ("CAT"), see also Cartlidge & Broderick (2009). In this case, the CC considered that a divestment of shareholding to a level below 7.5% would be effective in remedying the substantial lessening of competition and the adverse effects resulting from the acquisition.

Under the Entreprise Act 2002, UK merger jurisdiction deals with three levels of ownership interest: (i) a "controlling interest", known as *de jure* or legal control (greater than 50% share of voting rights); (ii) the "ability to control policy", known as *de facto* control (shareholdings below 50%); and (iii) the "ability materially to influence the policy" of the target company, known as material influence. "A shareholding conferring on the holder 25 per cent or more of the voting rights in a company generally enables the holder to block special resolutions; consequently, a 25 per cent share of voting rights is likely to be seen as presumptively conferring the ability materially to influence policy – even when all the remaining shares are held by only one person. The OFT may examine any case where there is a shareholding of 15 per cent or more in order to see whether the holder might be able materially to influence the company's policy. Occasionally, a holding of less than 15 per cent might attract scrutiny where other factors indicating the ability to exercise influence over policy are present"[24].

Scrutiny is on a case-by-case basis, and to assess whether there is an acquisition of "material influence", the OFT will take into account: "the distribution and holders of the remaining shares; patterns of attendance and voting at recent shareholders' meetings; the existence of any special voting or veto rights attached to the shareholding under consideration; and any other special provisions in the constitution of the company conferring an ability materially to influence policy" as well as "whether the acquiring entity has or will have board representation" and "whether any additional agreements with the company enable the holder to influence policy"[25].

In the case of Norway, notwithstanding the harmonization of the Norwegian competition law with the European Union merger control rules, in its revision of 2004[26], the Norwegian Competition Authority maintained the possibility to intervene against an acquisition of shareholdings in an undertaking even if the acquisition will not lead to control of that undertaking.

The acquisition of minority shareholdings is a concern in Norway in particular due to the structure of the Norwegian electricity market, characterized by high concentration of ownership and extensive direct and indirect owner-

24 See OFT Mergers – Substantive Assessment Guidance (2003), §2.10.

25 *Ibidem*.

26 Act on Competition between undertakings and control of concentrations, 5 March 2004 (Competition Act 2004).

ship relations between different companies (minority shareholdings, cross-ownership and joint ownership)[27].

Considering the different regimes of merger control, some of which, as described above, apply merger rules to the acquisition of minority shareholdings independently of the acquisition of control, may be important to discuss whether the Portuguese Competition Law should evolve to allow for acquisitions of non-controlling minority shareholdings to be under the PCA's merger jurisdiction.

In 2001, the European Commission addressed the issue of passive investments in the Green Paper on the Review of Council Regulation (EEC) No 4064/89, recognizing that "a minority shareholding (potentially coupled with interlocking directorships) may alter the linked companies' incentives to compete and thus have an impact upon market conditions"[28].

The Commission considered, however, that it would seem disproportionate to subject all acquisitions of minority shareholdings to the *ex ante* control of the Merger Regulation, as "it appears that only a limited number of such transactions would be liable to raise competition concerns that could not be satisfactorily addressed under Articles 81 and 82 EC"[29]. Moreover, the Commission questioned "whether an appropriate definition could be established capable of identifying those instances where minority shareholdings and interlocking directorships would warrant such treatment".

The EC Merger Regulation (ECMR)[30] of 2004 still limits the application of merger control to acquisitions of control, as the Commission and the Member States considered that an *ex-ante* notification mechanism would impose an unnecessary burden on companies, and that Articles 81 and 82 EC were adequate to address the competition concerns that could arise from passive investments.

Ezrachi & Gilo (2006) discuss how Articles 81 and 82 EC may fill the gap left by the ECMR in the regulation of passive investments. The analysis of the

27 See Singh & Skjeret (2006). See also the Report No. 1/2003 of the Nordic Competition Authorities.

28 See Green Paper on the Review of Council Regulation (EEC) No 4064/89, §107.

29 *Idem,* §109.

30 Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings.

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Philip Morris case[31], the BT/MCI case[32] and the Olivety/Digital case[33] seem to point to a narrow application of Article 81 EC, as the European Court of Justice, in the Philip Morris case, has focused on cooperation and influence. As stated by the Commission in the BT/MCI case, "[a]s a general rule, both the Comission and the Court of Justice have taken the view in the past that Article 85(1) does not apply to agreements for the sale or purchase of shares as such. However, it might do so, given the specific contractual and market contexts of each case, if the competitive behaviour of the parties is to be *coordinated* or *influenced*". Consequently, as highlighted by Ezrachi & Gilo (2006), "Article 81 EC could potentially cover cases where passive investments failing short of establishing *control*, facilitate coordination or enable *some* influence. Yet, it is not applicable to passive investments which give rise mainly to unilateral anticompetitive effects"[34].

In what concerns the application of Article 82 EC, Ezrachi & Gilo (2006) consider it is rather limited, as it only applies to minority shares when involving a dominant acquiring firm, and when those shares enable the dominant company to indirectly influence (a *de jure* or *de facto* influence, falling short of the notion of control) the behaviour of its rival.

Considering there is a regulatory gap which enables passive investments which result in pure unilateral effects to be unchallenged, Ezrachi & Gilo (2006) suggest an *ex-post* review for acquisitions of non-controlling minority shareholders, which would be pursued by the Commission in exceptional cases, when market concentration and characteristics indicate that such investments may be substantially harmful for competition[35]. This would have the advantage of not increasing the burden on firms and the Commission that would result from an *ex-ante* review, and, when necessary, a de-merger would not be a difficult exercise, as it would only involve the sale of the minority shareholding.

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31 Cases 142/84 and 156/84, *British American Tobacco Company Limited and R. J. Reynolds Industries Inc. V E.C. Commission (Philip Morris Inc. and Rembrandt Group Limited intervening)* before the Court of Justice of the European Communities (6th Chamber) [1987] ECR 4487; [1988] 4 CMLR 24.

32 Case IV/34.857, *BT/MCI* [1994] OJ L 223/36.

33 Case IV/34.410, *Olivetti/Digital* [1994] OJ L 309/24.

34 Ezrachi & Gilo (2006: 342).

35 This would require the definition of thresholds for intervention, in terms of the level of concentration of the markets and the level of the passive investment.

As referred by the authors, the economic analysis on the effects of passive investments is very similar to the analysis of horizontal mergers, both on its unilateral and coordinated effects. Furthermore, the substantive test underlying the ECMR could also be extended to cover passive investments. The inclusion of an *ex-post* assessment in the ECMR would also have the advantage of flexibility, compared to the application of Articles 81 and 82 EC.

Taking into consideration that most passive investments are benign, it would seem disproportionate to introduce the need for mandatory notification of those acquisitions in a future review of the Portuguese Competition Law, as it would impose unnecessary burden on undertakings and on the PCA, in detriment of the capacity to review acquisitions of control. One should also note that the notion of control is not limited to *de jure* control but also to *de facto* control, encompassing already a broad scope, allowing merger control to capture the ability to exercise a decisive influence on an undertaking.

Articles 4 and 6 of the Portuguese Competition Law would also allow addressing the competition concerns originated by passive investments, at least partially, if one applies a similar reasoning as in Ezrachi & Gilo (2006). For those situations which might not be captured by the present merger regime or by Article 4 or 6, perhaps a discussion on the merits of an *ex-post* solution, as suggested by Ezrachi & Gilo (2006), should be undertaken in the context of a revision of the Portuguese Competition Law.

COMMON SHAREHOLDERS IN COMPETING FIRMS

A recent case[36] analysed by the PCA raised the issue of whether common shareholders in competing firms could lead to considering the two companies as a single economic unit, under the concept of undertaking, given by Article 2 of the Portuguese Competition Law[37].

Until November 2007, Portugal Telecom (PT), Portugal's largest telecommunications operator, held a 58% share of PT Multimedia. The two firms were active in the same relevant markets (namely broadband Internet services

36 See Case Ccent. 56/2007 – CATVP/BRAGATEL/PLURICANAL, 21.11.2008.

37 Article 2 (1) states: "For the purposes of this Act, an undertaking is considered to be any entity exercising an economic activity that consists of the supply of goods and services in a particular market, irrespective of its legal status or the way in which it functions"; which is complemented by article 2 (2): "A group of undertakings is considered as a single undertaking if, though legally distinct, they make up an economic unit or maintain ties of interdependence or subordination among themselves arising from the rights or powers set out in Article 10 (1)".

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and voice telephony) or in related markets in the telecoms sector. Given the interdependence between the two firms and the existing legal link of subordination, the PCA has considered they constituted a single economic unit, and a sole undertaking[38], for the purposes of application of the competition law.

Following a decision by PT's general assembly of shareholders, PT pursued the spin-off of PT Multimedia, in November 2007, with the distribution to its shareholders of its interest in PT Multimedia. At the time, the PCA was analysing the acquisition by PT Multimedia (presently ZON) of two cable operators, notified in August 2007.

Initially, as stated in the final decision of the merger case[39], the presence of a set of reference shareholders, which were common to both firms, did not allow the PCA, when deciding to proceed to in-depth investigation, to rule out the possibility that the two firms still constituted one same undertaking, according to Article 2 of the Competition Law. The PCA identified certain factors, given the significant overlap in ownership of both firms, which could lead to this possibility: the voting by shareholders with qualified participations in both companies had been enough to approve relevant matters in general assembly; the existence of common interests between common shareholders; the Boards of Administration of both firms were previously proposed by the same shareholders, which could happen in the future; there were interdependence relationships, namely in what concerns service contracts.

Nonetheless, in the final decision, the PCA, having analysed the effectiveness of the spin-off, concluded the two firms would be considered two independent undertakings, in line with the understanding expressed by the sector regulator, ICP-ANACOM. The PCA considered, also taking into account the evolution of shareholders' positions after the spin-off, that there was no concrete proof of common interests between shareholders, and that one would have to wait for the next election of the board of Zon to see how the choice of the board members would occur. Moreover, part of the contracts between the two companies had already been terminated and others were about to be terminated. Legal and accounting separation of the two firms, together with the observed market behaviour, with the launching of competing offers by the two companies, led the PCA to conclude for the separation of PT and Zon, in the application of competition rules.

38 See, for example, Case Ccent. 08/2006 – Sonaecom / PT, 22.12.2006.

39 See Decision on Case Ccent. 56/2007 – CATVP/BRAGATEL/PLURICANAL, §17, 21.11.2008.

Although it might be juridically controversial, the existence of common minority shareholders in competing companies may lead to considering those companies to integrate the same economic unit, for the purposes of applying competition law. There is an economic rationale to support such a position, as is well expressed in Brito, Cabral & Vasconcelos (2008), on "Duopoly Competition with Common Shareholders".

Building on the work of Reynolds & Snapp (1986), Bresnahan & Salop (1986), and Flath (1992), which was concerned with the case when firms own shares in rival firms, Brito, Cabral & Vasconcelos (2008) consider the case of shareholders who hold positions in more than one firm. In a duopoly setting, the authors develop a methodology for evaluating competition and welfare when shareholders hold (partial) positions in more than one competitor, either directly or through cross-holdings.

The paper develops a Cournot model (capacity competition) and a Hotelling model (to take into account differentiated products), considering shareholder weight (both in terms of share holdings and of voting rights). In a situation where several shareholders hold partial shares in both competitors, market performance will be somewhere between the extremes of monopoly (the case if one shareholder owns or controls both firms) and duopoly with totally independent firms.

It is assumed that each firm will maximize a weighted sum of all of its shareholders' payoffs, where ownership shares are the weights considered. The firm's maximization will take into account that there are shareholders with direct and indirect interests in both firms. The study shows that an increase in common holdings (shareholder k owning shares in firms i and j) or in cross holdings (firm i owning shares in firm j) leads to a decrease in welfare.

The authors have applied the model to the spin-off of PTM by PT, considering the shareholder composition just after the spin-off, and concluded that it hardly improved the conditions for market competition, if at all. On the contrary, if PT would have sold its share on PTM to independent shareholders, it would have considerably improved consumer welfare through increased competition. An additional improvement, they state, would have been obtained by completely separating the set of shareholders in PT and PTM.

Irrespective of the conclusion on the PT and PTM separation, competition agencies should be aware of the implications of common shareholders in competing firms, which may, in some particular cases, lead to consider those firms as one economic unit for the application of competition rules.

MINORITY SHAREHOLDINGS IN REMEDY IMPLEMENTATION

Structural links and interlocking directorates, in the context of merger assessment, may raise competition concerns which are only removed by the imposition of remedies[40]. However, even when a merger does not pose such concerns, the implementation of remedies may require an analysis on the existing equity interests. This may be the case when, for instance, a remedy consisting on the divestiture of a business or assets was imposed and the competition agency has to evaluate the independent nature of the potential acquirer, or its ability to compete effectively in the market, as the acquirer may have equity interests in the merged entity.

In June 2008, in order to allow for a clearance decision by the PCA concerning the acquisition of EDIA Assets[41], EDP Produção, the main energy company in Portugal, proposed a remedy which consisted in a temporary lease agreement for 5 years, to an independent third party, for the management of the hydro power plants of Aguieira and Raiva.

Both the manager and the lease agreement where subject to the PCA's approval. The third party proposed by EDP for the celebration of the Lease agreement was Iberdrola, the Spanish energy group, which holds a shareholding of 9.5% on EDP.

One of the issues covered in the analysis developed by the PCA, towards the approval of the candidate manager, was the impact of this minority shareholding of Iberdrola on EDP in terms of the management of the leased power plant.

The issue at stake, which was also raised by a third party in a letter addressed to the PCA later on, was whether one could assure that Iberdrola would manage Aguieira and Raiva independently of EDP.

40 The European Commission has considered, in several mergers, as a remedy, the divestment of minority shareholdings or the abandoning of interlocking directorates. See, for example, Case M. 1080 – Thyssen / Krupp, 2.6.1998; Case M. 1712 – Generali / INA, 12.1.2000; Case M. 1980 – Volvo / Renault, 1.9.2000; Case M. 3696 – E.ON / MOL, 21.12.2005; Case M. 3653 – Siemens / VA Tech, 13.7.2005.

41 See Case Ccent. 06/2008 – EDP / Activos EDIA (Pedrógão*Alqueva), 25.06.2008. By means of this merger, notified to the PCA in January 2008, EDP Produção, part of Grupo EDP, the largest electricity company in Portugal, active at the level of electricity generation, distribution and supply, was acquiring assets of the public company EDIA – Empresa de Desenvolvimento e Infra-Estruturas de Alqueva, S.A., namely the exploration rights for the hydroelectric component of the infra structures of EFMA – Empreendimento de Fins Múltiplos de Alqueva (Alqueva and Pedrogão's hydro-power plants), together with the right to proceed with a private exploration of the public hydro domain for the production of electricity and implementation of infrastructures for that purpose.

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Even if no concerns could be raised regarding the independence of Iberdola and EDP in terms of control relationships, the same conclusion was not immediately straightforward in what concerned the economic incentives that would dominate in the management by Iberdrola of Aguieira and Raiva power plants.

One of the dimensions that were important in the assessment of the remedy, in terms of its impact in mitigating the increased market power that EDP would enjoy as a result of the merger[42], was the fact that the power plants to be leased were hydro power pants. Given the price-setting nature of hydro energy in Portugal, Aguieira and Raiva (both hydro power plants) were likely to have a stronger impact in mitigating EDP's market power following the merger than base load power plants[43].

However, Iberdrola's minority shareholding on EDP, the main electricity wholesale supplier – accounting for the majority of the electricity traded in Portugal –, raised issues in terms of the incentives of Iberdrola.

By managing Aguieira and Raiva independently of EDP, Iberdrola would obtain the profits for trading the electricity produced in those power plants. On the other hand, Iberdrola could manage Aguieira and Raiva strategically, by withholding electricity, in order to drive price increases. This price increase would apply to all the electricity traded by EDP in wholesale markets, thereby increasing the profits of EDP and, as such, Iberdrola earning's with its 9.5% shareholding. Given the fact that the energy traded by EDP is of various orders of magnitude higher than the electricity produced by Aguieira and Raiva, the issue was which of these effects would dominate in terms of the incentives driving Iberdrola's management of the two power plants.

The analysis conducted by the PCA demonstrated that Iberdrola's profit obtained by optimising its production in Aguieira and Raiva independently of EDP would always outweight the expected increase in the earnings associated with its 9.5% share in EDP, that would follow a strategic withhold of energy at the two power plants.

Independently of the final assessment on this particular case, this is an illustrative example of how minority shareholdings, even small, can drive

42 The competition concerns arising from the merger were related to the fact that EDP already accounts for the most part of the electricity production capacity in Portugal, endowing it with the ability to strongly influence the wholesale price of electricity.

43 See Federico & Lopez (2009) for the theoretical argument behind this statement.

economic incentives to an appreciable extent, and should be regarded with caution by competition authorities.

CONCLUSION

Merger Control in Portugal follows closely the European Union regime, and there is no jurisdiction over transactions which involve the acquisition of non-controlling minority shareholdings. However, this does not mean minority shareholdings have no role to play in merger control in Portugal. In fact, these minority shareholdings may be considered, for example, whilst analysing a notified merger (such as when a company which owns a passive interest in a company acquires control over a competing firm), or in the design and implementation of remedies. Minority shareholdings may also be relevant when there are common shareholders in competing firms, which, under certain circumstances, may imply considering those firms as one economic unit, for the purposes of the application of competition rules. We also presented a case of remedy implementation, where minority shareholdings in the merged entity were relevant in the assessment of the independent nature of a company which was proposed to manage a power plant, following a remedy imposed on EDP in a merger review by PCA.

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